COVID-19: (AUSTRALIA) NSW REGULATION FOR COMMERCIAL LEASES

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**This information is accurate as of 11:00 A.M. on 28 April 2020 and is subject to change as this situation evolves.*

On 7 April 2020, the National Cabinet issued a Mandatory Code of Conduct (the Code), which imposes a set of good faith leasing principles that apply to certain commercial tenancies experiencing financial stress or hardship because of the COVID-19 pandemic. You can read more about the Code and the emergency powers provisions in other states in our previous alert which can be found here.

On 24 April 2020, the Retail and Other Commercial Leases (COVID-19) Regulation 2020 (NSW) (the Regulation) commenced, giving effect to the Code and introducing conditions during the COVID-19 pandemic period which:

- prohibit and regulate the exercise of certain landlord rights to enforce terms under commercial leases, and
- require landlords and tenants to renegotiate rent and other terms of their commercial leases in good faith, having regard to the Code and prior to the enforcement of any legal action under their commercial leases.

In this article, we will discuss:

- Who is covered under the Regulation?
- When does the Regulation apply?
- What are the key provisions of the Regulation relating to impacted lessees?
- Has the Regulation clarified the uncertainties from the Code?

WHO IS COVERED UNDER THE REGULATION?

The Regulation applies to:

- retail shop leases under the Retail Leases Act 1994 (NSW), and
- other leases of land or premises for commercial purposes (other than agricultural leases), (commercial leases) which were entered into before the commencement of the Regulation ie prior to 24 April 2020.

The Regulation also applies to commercial leases entered into after 24 April 2020 by way of an option to extend or renew, or any other extension or renewal of an existing lease, on the same terms as the existing lease.

The Regulation does not apply to new commercial leases entered into after 24 April 2020 or any lease under the *Agricultural Tenancies Act 1990* (NSW).

The majority of the provisions of the Regulation apply to commercial leases where the tenant is an "impacted lessee". An impacted lessee is a tenant who:

- qualifies for the Commonwealth JobKeeper scheme, and
- had a turnover for the 2018-2019 financial year of less than AUD50 million.

Turnover for a tenant is to be calculated as follows:

- for a tenant that is a franchisee - by reference to the turnover of the business conducted from the premises
- for a tenant that is a corporation that is a member of a group (being a related corporation of other entities as defined in the Corporations Act 2001) - by reference to the turnover of the group, or
- for any tenant who does not fall within either of the above categories - by reference to the business conducted by the tenant (which could be premises specific or broad, depending on the operations of the particular tenant.

Further, in each of the above cases, turnover of the business includes turnover derived from internet sales of goods or services. We discuss this below.

While this mirrors the principles of the Code, some provisions of the Regulations have been applied more widely to include, in certain circumstances, all commercial tenancies (see our explanation below).

WHEN DO THE REGULATIONS APPLY?

The provisions of the Regulation commence on 24 April 2020 and are automatically repealed six months after the commencement of the Regulations, ie until 24 October 2020 (Prescribed Period).

WHAT ARE THE KEY PROVISIONS OF THE REGULATION RELATING TO IMPACTED LESSEES

Prescribed actions

A landlord must not take any prescribed action against an impacted lessee for breach of the terms of a commercial lease during the prescribed period, where the breach consists of the tenant's failure to:

- pay rent
- pay outgoings, or
- operate and open for business during the hours specified in the lease.

A "prescribed action" includes:

- eviction
- termination of lease
- right of entry
- recovery or possession of the premises or land

- distraint of goods (seizure of property in order to obtain payment of rent or other money)
- forfeiture
- damages
- interest or fee or charge relating to unpaid rent
- claim on the whole or part of a security or enforce guarantee, and
- any other remedy otherwise available at common law or under statute.

The restriction on the prescribed actions does not apply if the landlord is taking such action on grounds not related to the economic impacts of COVID-19.

However, practically speaking, if a tenant is an impacted lessee in respect of whom the prescribed action is prohibited, it is likely to be very difficult for a landlord to assert there were other grounds for the non-payment of rent, or outgoings, or the failure to open and operate for business.

Additional requirements

In addition to the prohibition on prescribed actions, if a tenant is an impacted lessee, a landlord:

- may not increase the rent payable under the commercial lease during the prescribed period (with exception to any component of rent that is determined by reference to turnover)
- may not take any prescribed action after the prescribed period against the tenant for failure to pay what would have been the rent increase during the Prescribed Period
- must pass through any reduction in land tax, other statutory charges or insurance premiums to the tenant, if the commercial lease would ordinarily require the tenant to pay a fixed amount in respect of those costs. We consider the legislative reference to fixed amount is intended to cover circumstances where tenants are required to pay a set proportion of those costs, and not simply a fixed amount be reference to a specified dollar figure.

Renegotiation

Where the tenant is an impacted lessee, any party to a commercial lease must, if requested by the other party, renegotiate in good faith the rent payable under, and any other terms of the lease. In conducting such negotiations, the parties must have regard to:

- the economic impacts of the COVID-19 pandemic, and
- the leasing principles set out in the Code.

Interestingly, the provisions requiring renegotiation states that landlords must not take or continue any prescribed action against an impacted lessee for failure to pay rent during the prescribed period unless the lessor has complied with the renegotiation clause (ie participated in any renegotiations requested by a tenant that is an impacted lessee).

This statement seems at odds with the earlier provision that sets out a blanket restriction on prescribed actions during for an impacted lessee's failure to pay rent during the prescribed period. It suggests that the landlord can

take a prescribed action provided it has participated in good faith in renegotiations at an impacted lessee's request.

The concern is that the language of this particular provision is not clear enough to reach a view with complete certainty that it is intended to override the blanket restriction on prescribed actions contained earlier in Regulation.

It could be argued that the implied permissive wording of this provision must have some meaning, such that it is intended to operate to relax the restriction on prescribed actions. This might be the case if the legislature intends for this provision operate as an incentive for landlords to renegotiate in good faith, by allowing them to then take the prescribed actions for failure by impacted lessees to pay rent during the prescribed period.

Future law protections

The regulation also provide that where a tenant is required to do or omit to do something pursuant to a law of the Commonwealth or the State that is brought into existence in response to COVID-19, such act or omission:

- will not be a breach of the commercial lease, and
- does not constitute grounds for termination or the permit any prescribed actions by the landlord.

This additional protection of tenants could have broad implications depending on what future laws may be brought into place. Practically speaking, it is most likely to apply in any circumstances where premises are ordered to close and, as a result, tenants cannot trade or meet other obligations under their relevant commercial leases where physical access to premises is required.

HAS THE REGULATION CLARIFIED THE UNCERTAINTIES OF THE CODE?

As mentioned in our previous alert, which can be found here, the Code contained several uncertainties regarding its application and implementation. Below we have revisited these uncertainties in light of the introduction of the Regulation:

What if a tenant is not an impacted lessee?

While the majority of the restrictions and obligations under the Regulation apply only to commercial leases where the tenant is an impacted lessee, the provisions that relate to disputes have been drafted to apply to all existing commercial leases regardless of whether the tenant is an impacted lessee.

For example, the Regulation provides that if a commercial lease is subject to the *Conveyancing Act 1919* (NSW), a landlord must not do any of the following unless and until the Small Business Commissioner has certified, in writing, that mediation offered to be conducted by the Small Business Commissioner has failed to resolve the dispute and given reasons for the failure:

- recover possession
- terminate the lease, or
- exercise or enforce any other rights of the landlord under the lease.

The Regulation does not qualify the commercial leases to which this provision applies by reference to impacted lessees. Regardless of whether this was intentional, the law as it is currently expressed broadly applies this particular provision to all commercial leases.

Does the Regulation apply to new leases entered into during the COVID-19 pandemic?

The Regulation applies to commercial leases entered into before 24 April 2020. The Regulation will only apply to leases entered into after 24 April 2020 in circumstances where that lease is entered into by means of an option to extend or renew, or any other extension or renewal of an existing lease, on the same terms as the existing lease.

The Regulation does not specify when a lease is "entered into". In the case of retail leases, the provisions of the *Retail Leases Act 1994* will apply (the lease will be entered into on the earlier of the date the tenant takes possession of the premises, commences paying rent or both parties have signed the lease). The position with respect to other commercial leases is not clear, particularly where the parties have entered into an agreements for lease with a lease commencement date after 24 April 2020. However, given the terms of the lease were negotiated prior to the COVID-19 pandemic and the general tenant friendly provisions in the Regulations, we expect that any dispute as to whether the Regulation applies would determine that a lease pursuant to an existing agreement for lease would be governed by the Regulation.

What evidence does a tenant have to provide to support financial stress or hardship and how do they demonstrate it is a direct result of the COVID-19 pandemic?

The Regulation does not provide any further guidance on what level of information is required to demonstrate the economic impact of the COVID-19 pandemic on the tenant.

Under the Code, landlords and tenants are expected to provide "sufficient and accurate information" within negotiations, which is defined to include information generated from an accounting system and information provided to or received from a financial institution.

Given the lack of clarity of both the Code and Regulation in this regard, we expect there to be significant tension between landlords and tenants as to the scope of information which is appropriate for such purposes.

How is turnover determined?

he Regulation has clarified that "turnover" is calculated by reference to the 2018-2019 financial year and that turnover includes any turnover derived from internet sales of goods and services.

How do turnover tests apply to tenants that are part of corporate group or a franchise structure?

If the tenant is a franchisee - the turnover considered is the business conducted at the premises or land concerned corporation that is a member of a group (ie related bodies corporate under the *Corporations Act 2001* (Cth)) - the relevant turnover is the turnover of the group, and in any other case the turnover of the business conducted by the tenant.

Are tenants entitled to a reduction in rent due to COVID-19? For how long?

Where tenants are impacted lessees, they are able to request to renegotiate, in good faith, the rent payable under the lease.

Under the Regulation, the parties must renegotiate the rent payable with regard to:

- the economic impacts of the COVID-19 pandemic, and
- the leasing principles set out in the Code.

In particular, Principle 3 of the Code states that landlord must offer tenants proportionate reductions in the rent in the form of waivers and deferrals.

However, the Regulations do not shed any further light on our previously raised questions regarding payment of any deferred rent amount where a lease expires before the pandemic ends and how the landlord retains the contractual right to recover any rent.

Landlords who agree to any deferral arrangements should document the obligation to pay deferred rent and the ability to have recourse to security where deferred rent obligations are not met.

What happens to rent reviews during the crisis period?

For an impacted lessee, the Regulation provides that the rent cannot increase other than by reference to turnover.

However, in this regard, the wording of the relevant provision is unclear as to whether rent reviews / increases can be applied for the balance of the lease year, once the prescribed period for the Regulation has elapsed.

The lack of clarity arises because the provision does not expressly state that the period during which the rent must not increase is the prescribed period. Instead, the provision reads that the rent may not increase if the tenant is an impacted lessee during the prescribed period. So, the reference to prescribed period reads as a test applicable to the tenant, rather than the period during which rent cannot increase.

However, as the Regulation is only effective for the prescribed period, once the prescribed period elapses, the Regulation will no longer apply. So, there is a strong argument that at that point, rental increases can apply on a going forward basis. Again, it would be better if the Regulation was clearer in this regard.

What about outgoings?

If an impacted lessee is required under its lease to pay a fixed contribution to outgoings paid by the landlord for land tax or other statutory charges or insurance and the landlord's costs in this regard are reduced, the impacted lessee is exempted to the extent of the reduction.

While the Code requires landlords to pass on the benefit of any deferral of loan repayments to the tenant on a proportionate basis, the Regulation does not prescribe this. Accordingly, the passing on of the benefit of any deferral of loan payments will be subject to the good faith negotiation between the parties, which requires the parties to have regard to the Code.

Similarly, while the Code requires landlords to waive the recovery of outgoings or other expenses under a lease during the period that the tenant is unable to trade from the premises, the Regulation does not impose such an obligation. Again, waiver of outgoings (beyond statutory outgoings) or other charges during a period where the tenant is unable to trade will be subject to negotiation between the parties.

What about landlords who are facing financial hardship due to COVID-19?

The Regulation does not provide any further protection for landlord's facing financial hardships from the impact of COVID-19. However, as stated above, when renegotiating the rent and other terms under its commercial lease, both parties are to have regard to the economic impacts of the COVID-19 pandemic and the leasing principles set out in the Code. This includes Principle 4 of the Code which states that regard must be had to the landlord's financial ability to provide rent waivers.

What about shopping centres? Do landlords need to offer the same deal for all tenants within the same shopping centre or building?

No - the Regulation only provides that the parties are to renegotiate in good faith the commercial lease having regard to the economic impacts of the COVID-19 pandemic and the leasing principles set out in the Code.

The economic impacts of the COVID-19 pandemic will be different for all shopping centre tenants. The Code requires landlords to agree to "tailored, bespoke and appropriate temporary arrangements" for each tenant on a case-by-case basis.

If only a few tenants are left trading in a shopping centre or building, can the landlord close the building or shopping centre to reduce costs without incurring compensation claims from the remaining tenants?

The Regulation has not clarified this issue. Unless the Government issues a direction requiring closure, then the likely answer is that the landlord may be exposed to claims in the event of closure.

Is there a right for tenants to terminate the lease agreement due to COVID-19?

In the absence of a right of termination under a lease, no.

However, the Regulation does not prevent the parties from agreeing to take any action in relation to the commercial lease (including the landlord taking any prescribed action or the parties agreeing to terminate the commercial lease).

Can a landlord call on security during COVID-19?

The Regulation does not allow the landlord of a lease with an impacted lessee to call on a security bond or require performance by a guarantor.

Can a landlord terminate a lease during COVID-19?

If the tenant is an impacted lessee, the landlord cannot terminate the lease if the grounds of termination are the tenant's failure to, during the prescribed period:

- pay rent
- pay outgoings, or
- operate and open for business during the hours specified in the lease.

Regarding our previous question whether a landlord can terminate a lease during this period where there has been a persistent non-payment of rent prior to the COVID-19 period, the Regulations clarify that the landlord can take action regarding breaches of its lease not related to the economic impacts of the COVID-19 pandemic.

What happens if the parties can't agree?

Leases under the Retail Leases Act 1994 (NSW)

Disputes are to be determined in accordance with the usual dispute resolution procedures under Part 8 (Dispute Resolution) of the *Retail Leases Act 1994* (NSW). This requires disputes to be submitted to mediation before proceedings can be undertaken.

Other Commercial Leases

Disputes must be submitted to the Small Business Commissioner for mediation and the Small Business Commissioner must certify in writing that the mediation failed to resolve the dispute before proceedings can be taken.

Despite the introduction of the Regulation, concerns regarding the sheer volume of matters that may be referred for mediation remains a concern. The Regulation does not impose a timeframe within which a dispute must be resolved. It is entirely possible that rent relief arrangements to apply during the crisis period will still be unresolved well after the end of the pandemic.

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